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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

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October 6, 1994 DOCKET FILE COPY ORIGINAL

Ms. Meredith Jones
Chief
Cable Services Bureau
Federal Communications Commission
Washington, DC 20554

Dear Ms. Jones:

Susan Cosentino suggested I follow up with a letter to you regarding my ideas for "going forward" rules for the addition of channels by small operators. As you might recall, I was one of the small operators included in the telephone conference call of September 14, 1994, that was initiated by Susan and others on the FCC staff to solicit input from small operators. I subsequently wrote Susan a letter, dated September 15, 1994, in which I offered to help the staff if they were looking for new ideas.

As a note, I am not associated with any of the many cable lobbying groups. My suggestion for a "going forward" formula for small operators is my own and has not been reviewed by any committee or group. It is based on what I believe is a common sense approach to rates.

Before I suggest a formula, I would like to list some very basic concepts about cable systems and the services they offer. Sometimes the massive amount of materials and filings submitted to an agency tend to obfuscate the real issues at hand. Here are some very basic thoughts.

- Adding new channels is good for the system, its customers, and the industry.
- Some channels are better than others in terms of value to the average customer.
- Systems need financial incentives to invest in new reception equipment and license fees or they will not add channels. Systems are economic entities that need to recover their capital and operating costs in order to satisfy obligations to banks, vendors, employees, and investors.
- It is much harder for small systems to add channels because the investment needed to receive and transmit the programming is a major cost on a per subscriber basis, due to the smaller number of subscribers served.

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List A B C D E

- Small systems need the ability to add channels and recover their investment costs in a relatively short period of time (6-18 months) so they can keep adding channels on a regular basis.

- Small systems should be able to add channels with a minimum of administrative filings; whatever filings needed should be simple and easy for the operator and local government to understand and compile, and not require a computer.

- Finally, even though most small systems are often the only cable providers in their respective service areas, this does not necessarily mean the systems are earning "monopoly" profits. In fact, most small operators are not profitable, have seen their market value decline, and are living a hand to mouth existence.

If you accept the above concepts, then I would submit the formula below as a way to encourage small operators to add channels, while allowing the operator to make reasonable rate adjustments to recover the costs of adding the channel. The formula is as follows:

$$\frac{(\text{Capital Cost} \times 1.2)}{(\#\text{ customers rec new channel})} \div \text{capital recovery period} + (\text{license fee} \times \text{markup}) = \text{rate adjustment}$$

Where

<u>Capital cost</u> = actual cost of incremental equipment needed to add a channel times a factor to cover interest and a small return.

<u>Capital recovery period</u>: a minimum of 6 months, a maximum of 18 months at the option of the system. At the end of the capital recovery period this part of the rate increase would be removed from the rate or replaced by the capital cost incurred in adding an additional new channel. In this way, the operator is encouraged to add new channels on a regular basis.

<u>License fee</u>: the actual license fee cost of the service added.

<u>Markup</u>: an established fixed/variable amount that would be added to the license cost of the service. In general, the higher the license cost of the service, the higher the markup permitted. However, so as not to discriminate against lower

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cost services, there would be a fixed amount markup for any non-revenue producing channels. I would suggest a minimum of 20 cents per channel, plus a 35% markup of the actual license fee.

Here's an example. A 600 subscriber system wishes to add Turner Movie Classics (15¢ per subscriber) to its cable programming services tier. This addition would not require a new satellite dish, but would require the purchase of a satellite receiver, channel modulator, videocipher, associated wiring and minor parts. The actual cost of this equipment is \$2,700. The operator would like to add one new channel each year to keep up with customer demand and to try to remain competitive with DBS and wireless, so he chooses a 12 month capital recovery period.

Here is how the above example would work under the formula:

$$\left(\frac{\$2700 \times 1.2 = \$3240}{600}\right) \div 12 \text{ months} + (\underbrace{\$.15}_{\text{license fee}} + \underbrace{\$.20}_{\text{min. markup}} + \underbrace{\$.0525}_{\text{variable markup}}) = \$.85 \text{ rate adjustment}$$

In the above example, the capital component of the rate would be \$.45 and the programming component would be \$.40. After the capital recovery period, the \$.45 would removed from the rate unless the operator adds a new channel, which would require the recalculation of the capital component based on the actual costs of the new channel addition. The programming component would remain part of the rate as long as the channel is carried, and would be adjusted annually if the license fee changes, just as any other channel.

Notification of local officials, if needed, should be a simple process. Create a form called "EZ Add". The operator would fill in the blanks of the formula, attach capital cost estimates and license fee calculations 30 to 60 days in advance and that would be it. The city could request copies of invoices, if desired, to verify the capital costs. Reasonableness of license fees could be determined by the city by contacting the programming service, which would give the city a standard rate card cost without violating the confidentiality of a programmer agreement.

I don't believe there should be any restrictions on the number of channels added on an annual basis because small operators are very sensitive to local sentiment, and with DBS now available, there is competition to keep rates reasonable. Hopefully, in the near future, all the rate rules will go away and we can get back to the free enterprise system. However, I do understand the political realities of the present time.

I would suggest making the above formula available to all small operators in any headend of any size. The bigger the headend the smaller the rate increase. Using my example above, a 2,500 subscriber system would be able to increase rates by $.508, much less than the $.85 increase by the small, 600 subscriber system.

From 1987 - 1992, we regularly added channels to our line-ups, often in conjunction with a rate adjustment. I would estimate that over the years leading up to the rate freeze we increased line-ups by 30% to 50% in most of our headends. That all stopped in 1993 when the freeze and subsequent rate regulations took away the economic incentive to add new programming. We literally have not added a single new service in virtually any of our 125 headends since March, 1993. This is a shame, especially now that new programmers need the encouragement to survive and prosper. By implementing a simple, going forward formula for small systems and small operators, you'll help stimulate the growth of new programming services, while allowing the small operator a way to recover the costs of adding the new service. And customers, many of whom would like to see more channels will be much more satisfied.

Thanks for your consideration of the above. I hope it is helpful in your deliberations. As I noted earlier, no rules would be the best for small systems, but if we must have some rules, please at least give us some incentive to once again add channels to our line-ups.

I would be happy to discuss this further if you have questions or concerns. I also hope to be in Washington in late October and would enjoy meeting you personally.

Very truly yours,

Peter Locke
Vice President

PL:kc

cc: Susan Cosentino